

## SMARTER PERSPECTIVE: RISK MANAGEMENT

# A Dual Master/Substitute Servicing Structure Helps Yield Optimal Outcomes Right From the Start

By Samuel Suchowiecky

This is the second article in a two-part series outlining the many complexities of managing the affairs of distressed businesses having locations within the borders of Mexico. This follow-up topic explores the importance for companies, boards of directors, investors, lenders, business advisors and other stakeholders to ensure that a highly qualified and proven partner within the market is engaged as both a master and substitute servicer from the start as a means of ensuring continuity and limiting downside risk over the life of an investment.

In Mexico, the investment environment surrounding asset backed securities (ABS) is different than in the United States, and some investors have learned a lesson the hard way when faced with unanticipated defaults by their borrowers. In fact, as press accounts have outlined over the past year or so, some sizeable and notable companies in Mexico have restructured, defaulted on their debt obligations, and/or filed for bankruptcy. These companies have attracted attention because their performance may be a bellwether for the region, and the investment community has taken notice.

Despite the challenges, however, many such borrowers in Mexico do manage to cover their payment obligations to



investors in a timely manner. Importantly, these success stories have some commonalities, one of which is rooted in setting up a sound structure for the both the deal and its ongoing oversight from the onset. By separating the credit risk of the instrument from that of the servicer, even distressed situations can result in positive outcomes by benefiting from a solid servicing structure with experienced trustees in place.

### A RECENT EXAMPLE ILLUSTRATES THE POINT

In July 2021, Alpha Holding S.A. de C.V., defaulted on its debt obligations and subsequently filed for bankruptcy protection in Mexico. Alpha's auditor had discovered inaccuracies in the company's financial statements, which

triggered the restructuring announcement and ultimately the liquidation. At the time, one of the subsidiaries, Alpha Credit Capital, S.A. de C.V., held a series of outstanding notes that were part of the bankruptcy.

In the Alpha Credit case, Hilco Terracota, an arm of Hilco Global Mexico which specializes in master and loan servicing, was the acting master servicer and was then appointed as substitute servicer during the liquidation. Having performed the role of master servicer, Hilco Terracota was up to speed on the company's operations, and uniquely well-positioned to take on the substitute servicing role with no real learning curve to climb. At a critical time for the company, its lenders and advisors, the Hilco Terracota team was able to step in with a full understanding of the many



## Benefits of Appointing a Single Firm as Both Master and Substitute Servicer

- Supported by the Mexican regulatory framework
- Puts lenders in control of their response to any situation
- Guarantees knowledge & readiness when activation is required
- Allows an existing loan payment structure to remain intact
- Provides for timely payment of investors

nuances of the portfolio assigned to the Trust. This allowed for both the timely identification of inconsistencies and the reconciliation of issues with Alpha Credit, paving the way for creditors to be paid with minimal delay. This consistent presence also served to reassure creditors throughout the process, reducing uncertainty and instilling confidence in an ultimately positive outcome.

In situations such as these, employees of distressed entities engaged in an active restructuring are frequently dealing with multiple advisors and lawyers, yet often are not well informed about what they can and cannot reveal to outside parties. It is also worth noting that significant numbers of employees frequently depart a company during

such a period, leaving key operational tasks overlooked and/or unperformed. As such, these are additional and compelling reasons for a master servicer to be assigned to take over as substitute, filling any gaps during the restructuring environment.

For Alpha Credit's stakeholders/creditors, having Hilco Terracota serve as substitute servicer resulted in the existing payment structure remaining intact. Furthermore, the efficiency and continuity this approach provided, enabled investors to be paid in full one year ahead of schedule. The outcome that was achieved helps to demonstrate why the set-up of this type of servicing structure from the start is both advisable and beneficial.

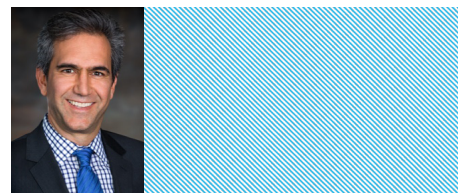
Importantly, whether a transaction involves a public or private entity in Mexico, the regulatory framework supports the appointment of a single firm as both master servicer in parallel with the role of substitute servicer. The arrangement guarantees that the substitute will be knowledgeable about the company's financials, and ready if/when the call comes. Creditors strengthen their positions when they have the built-in support of a well-informed advocate. Ultimately, assigning one company in the dual master/substitute role serves to put lenders in control of how they can respond not only to opportunity, but in crisis as well.

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and redeveloped real estate. Hilco Global Mexico's leadership team is experienced in Latin America markets and can deliver local expertise while tapping into Hilco Global's worldwide resources.

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